

Issue Paper Number 99-050



BOARD OF EQUALIZATION
KEY AGENCY ISSUE

- ☐ Board Meeting
- ☐ Business Taxes Committee
- ☐ Customer Services Committee
- ☐ Legislative Committee
- ☒ Property Tax Committee
- ☐ Technology & Administration Committee
- ☐ Other

PROPERTY TAX RULE 10

TRADE LEVEL FOR TANGIBLE PERSONAL PROPERTY

I. Issue

Should the Board authorize publication of proposed amendments to Title 18, California Code of Regulations, Property Tax Rule 10?

II. Staff Recommendation

Staff recommends that proposed amendments to Property Tax Rule 10 as shown on Attachment A, "SBE Staff Version," be authorized for publication and submitted to the Office of Administrative Law for publication in the California Regulatory Notice Register. *[Assessors concur with staff.]*

III. Other Alternative(s) Considered

1. Adopt, and authorize for publication, Industry's proposed amendments to Property Tax Rule 10 as shown on Attachment B, "Industry Version" (deletions and modifications to staff's proposed amendments are shown on the attached matrix, Attachment C). Submit the revised rule to the Office of Administrative Law for publication in the California Regulatory Notice Register.

Issue Paper Number 99-050

IV. Background

Under Government Code section 15606, subdivision (c), the Board is given the authority to prescribe rules and regulations to govern local boards of equalization when equalizing and assessors when assessing. Accordingly, staff was directed to review and revise Property Tax Rule 10 (Section 10, Title 18, of the California Code of Regulations). Consistent with this direction, the staff of the Property Taxes Department and Legal Division drafted proposed amendments to Property Tax Rule 10, and disseminated a draft of the rule to interested parties (February 25, 1999, Letter to Assessors (LTA) 99/17).

After requesting and receiving comments from interested parties regarding the proposed revision, a second draft of the rule was prepared and disseminated. On June 22, 1999, staff held a meeting in Sacramento with interested parties to attempt to reach agreement on the issues and language of the proposed revisions. Following that meeting four areas of disagreement remained, and the issues were scheduled to be heard at the September meeting of the Property Taxes Committee. Due to ongoing discussions and concern about the issues, however, the discussion of Rule 10 and related issues was rescheduled to the Committee's calendar in November.

Staff was directed by management to continue working with interested parties until October 6, 1999 in an effort to resolve issues and wording differences related to the rule. At that time this issue paper was drafted, finalized, and submitted to the Property Tax Committee for discussion at its November meeting.

There are two areas of disagreement remaining regarding Rule 10 which are set forth below in the form of questions:

1. Do trade level adjustments apply in the valuation of personal property that has been affixed to real property (fixtures)?
2. In the determination of a trade level factor, should the full economic cost include an allowance for non-property items?

V. Staff Recommendation

A. Description of the Staff Recommendation

Staff recommends that proposed amendments to Property Tax Rule 10 as shown on Attachment A, "SBE Staff Version," be authorized for publication and submitted to the Office of Administrative Law for publication in the California Regulatory Notice Register.

Rule 10 provides guidance in applying the trade level principle. The proposed language of Rule 10 is consistent with the statutory and constitutional requirements that all property be assessed at fair market value. Section 110(a) of the Revenue and Taxation Code defines "fair market value" or full cash value as the "amount of cash or its equivalent which property would bring if exposed for sale in the open market under conditions in which neither buyer or seller could take advantage of the exigencies of the other." The Constitution requires that all taxable property must be assessed at "fair market value" (Article XIII, § 1(a)). The trade level concept ensures that property is valued at fair market value rather than book value. Trade level adjustments ensure assessment uniformity for

FORMAL ISSUE PAPER

similar property that may be acquired through different means (i.e. self-constructed or leased versus property purchased by a consumer). Without a trade level adjustment property may be valued above or below its fair market value.

Under staff's proposed Rule 10, all property must be assessed at the proper level of trade based on its location and use on the lien date. An appraiser must recognize that property normally increases in value as it progresses through production and distribution channels to the consumer, whether or not the cost or value added is booked in accounting records. The trade level concept, as described in staff's proposed version of Rule 10 (Attachment A), is applicable when book cost does not provide adequate information for making a fair market value appraisal. It is most frequently applied to leased equipment and self-constructed equipment.

B. Pros of the Staff Recommendation

Staff's recommendation addresses the two questions outlined in Part IV "Background" of this issue paper in the following manner:

1. Do trade level adjustments apply in the valuation of personal property that has been affixed to real property (fixtures)?

Yes. Staff and county assessors believe that general trade level principles are applicable to all types of taxable property, both real and personal for the following fundamental reasons: (1) the need to meet the constitutional requirement of fair market value as defined in section 110; and (2) the need to recognize the principle of fairness and equity in the assessment of property that has been enunciated by the courts in a number of cases. In *Xerox Corp. v. County of Orange* (1977) 66 Cal.App.3d 746, the court said at page 755:

"...the trade level concept is useful in assessing the leased property for two reasons; namely, it establishes the trade level at which the property is to be appraised and it focuses on the elements that help establish the market price."

"...the trade level theory produces equity between taxpayers by assuring that the taxpayer consumer who owns his equipment will pay the same tax on identical equipment, as the taxpayer who leases the equipment to the ultimate consumer. The market value of the property is the same if the property is held by the ultimate consumer regardless of who pays the tax."

(See also *Beckman Instruments, Inc. v. County of Orange* (1977) 53 Cal.App.3d 767 at 782 and *Ex-Cell-O Corp. v. County of Alameda* (1973) 32 Cal.App.3d 135 at 141.)

General trade level principles can apply to any type of property, and are similar to the stage of production principle as discussed in Assessors' Handbook Section 501 (AH 501), *Basic Appraisal* (September 1997, p. 12-13). If applying a trade level adjustment to a fixture results in fair market value and equity between taxpayers, then it is an appropriate adjustment whether or not it is specifically identified in a Board rule. Excluding fixtures from the rule does not mean that trade level theory does not apply to fixtures but it may cause difficulty in applying trade level adjustments when appraising personal property affixed to real property (fixtures). Since fixtures are real property, changing the title of the rule to "Trade Level" would be necessary if staff's version is adopted.

Currently, confusion exists as to the rule's application to fixtures. For example, if a trade level adjustment is appropriate in determining the full economic cost of a printing press classified as personal property (not affixed to real property), would a similar trade level adjustment be appropriate

FORMAL ISSUE PAPER

for an identical printing press affixed to real property (fixture)? Staff believes the rule should be revised to eliminate this confusion and promote uniformity of assessment practices. If fixtures are not specifically included in the rule, the rule may lack "clarity" as required by Government Code section 11349.1 when reviewed by the Office of Administrative Law (OAL).

2. In the determination of a trade level factor, should the full economic cost include an allowance for non-property items?

The full economic cost should not include non-property items unless they are separately purchased. The costs of non-property items are appropriate adjustments to the calculation of retail trade level factors *only* when such costs are separately stated. For example, Industry uses warranty as an example of non-property. If an extended warranty were purchased it would be appropriate to make an adjustment for this item (as listed on the sales contract). If, however, the warranty is not listed separately but merely the warranty required by law or otherwise "typically" included with the product (i.e., not separately stated and priced), no adjustment is appropriate.

Staff's proposed language does not discuss "non-property items" and is consistent with the trade level discussion in Assessors' Handbook Section 504 (AH 504), *Assessment of Personal Property and Fixtures*. In AH 504, "non-property items" are discussed under the heading "Discounts/Adjustments". AH 504, at page 59, states:

"Adjustment may be appropriate when non-property items have been included in a purchase contract. Extended service plans and warranties, supplies, other purchased assets or business services may have been included in the purchase contract. An adjustment may be appropriate for the fair market value of these assets."

"Non-property items" in this context is used to define or describe items, which may be included in the purchase price, other than the specific property being valued. Each "non-property item" listed in this text would generally be a separately listed item on the sales contract. "Non-property items" is only meant to be used in the context of the discussion in AH 504. The term should not be utilized without explanation, or taken out of context and applied to non-property items not separately stated in a sales contract.

(Additional arguments for staff's position can be found in Alternative 1, Cons of the Alternative)

Note: Footnote 118 in AH 504, as mentioned by industry in Alternative 1, Pros of the Alternative, is based on current Rule 10. This footnote would be deleted if staff's version were adopted.

C. Cons of the Staff Recommendation

1. Industry does not believe the inclusion of fixtures in Rule 10 is appropriate. Industry cites a recent unpublished court case which refers to trade level in support of their position. Industry believes that leaving Rule 10 silent as to fixtures would not preclude the use of trade level in valuing fixtures but that the rule would cause confusion if fixtures were included. (See also Alternative 1, Pros of the Alternative.)

The letter referenced by Industry from senior staff counsel James M. Williams discussed the application of Rule 10 (as it was at that time) as applied to fixtures in relation to that particular situation (see Alternative 1, Pros). The William's letter carries no weight because it is not an annotated legal opinion of the Board.

FORMAL ISSUE PAPER

2. Industry believes that non-property items, whether or not separately stated, should not be included in the trade level adjustment. In industry's view, staff's language does not give adequate guidance for adjusting full economic cost to exclude all non-taxable property, resulting in the overvaluation of some property.

(Additional arguments for Industry's position can be found in Alternative 1, Pros of the Alternative.)

D. Statutory or Regulatory Change

Action by the Board on the attached Property Tax Rule will amend Section 10, Title 18 of the California Code of Regulations.

E. Administrative Impact

None

F. Fiscal Impact**1. Cost Impact**

None

2. Revenue Impact

See Attached Revenue Estimate

G. Taxpayer/Customer Impact

None

H. Critical Time Frames

The lien date is January 1 for the assessment year July 1 through June 30. In order for assessors to have this guidance for the processing of the 2000-01 roll the Board should authorize publication of amendments to the Rule at its November 1999 meeting.

VI. Alternative 1**A. Description of the Alternative**

The Board could adopt Industry's proposed amendments to Property Tax Rule 10. Attachment B shows Industry's proposed revisions to the current Rule 10.

Differences between staff's proposed Rule 10 and Industry's proposed Rule 10 are arrayed on the attached matrix (Attachment C). Industry's version (Attachment B) of Rule 10 differs from staff's version (Attachment A) in two respects: (1) industry deletes staff's references to fixtures, and (2) industry includes adjustments for non-property items while staff's version is silent.

FORMAL ISSUE PAPER**B. Pros of the Alternative**

Industry's recommendation addresses the two questions outlined in Part IV "Background" of this issue paper in the following manner:

1. Do trade level adjustments apply in the valuation of personal property that has been affixed to real property (fixtures)?

No. Industry does not think that the inclusion of personal property that has been affixed to real property in Rule 10 is appropriate.

[The following text was submitted by the California Taxpayers' Association (Cal-Tax)]

Assets with a fixture classification are typically acquired at "arm's length" and should not be trade leveled. Fair market value for fixtures can be determined without applying trade level. Many taxpayers have experienced problems in some counties, where assessors incorrectly apply trade level adjustments to fixtures. The staff's proposed language would reinforce that practice. Fixtures are not now included in Rule 10, and industry believes it would be incorrect to add them to the new rule.

The stated purpose of updating Rule 10 is to conform the rule to current law, and hopefully to provide clarity for taxpayers and assessors. By including fixtures in Rule 10, we are concerned that neither conformity nor clarity will be served and that county assessors will apply trade level adjustment that are inappropriate and could be illegal. Moreover, recent court cases have held that fixtures are real property, not tangible personal property. It would appear to present a confusing, if not conflicting, situation to include fixtures in a rule pertaining to tangible personal property.

Including fixtures in Rule 10 would also be inconsistent with AH 504 Footnote 118 on page 60 of the handbook. Footnote 118 in the Trade Level section directs readers that fixtures should be assessed at the appropriate stage of production rather than trade level, as described on page 13 in AH 501. By removing the last sentence of paragraph (a) in the proposed Rule 10, the conflict with AH 504 and AH 501 would disappear.

The only valid reason for originally including fixtures in Rule 10 appeared to be justification for using trade level to value propane tanks under Rule 10. Now that Rule 153 is being proposed for the valuation of propane tanks, reference to fixtures in Rule 10 is unnecessary and creates confusion and inconsistency. Leaving Rule 10 silent as to fixtures does not absolutely preclude the use of trade level, but readers would not be unnecessarily confused by its inclusion.

[The following text was submitted by the Western Propane Gas Association.]

The SBOE has previously researched the issue of whether "fixtures" can be taxed under Rule 10 and it has concluded that they cannot. On May 4, 1992 senior staff counsel James M. Williams wrote the letter to the County of San Luis Obispo which stated "...if the tanks have already been classified as improvements, then Rule 10 is not applicable because by its own explicit term it controls only the appraisal of tangible personal property."

The history of this issue only highlights the need for a separate Rule 153. At that time of Mr. Williams's above-referenced letter, the local assessor was initially treating propane tanks as "fixtures" and the State Board of Equalization took the position that they were actually "personal

FORMAL ISSUE PAPER

property". Subsequently Rule 124 was changed so that the tanks would be classified as "fixtures". While this was happening, the case of *J.W. Platz, et al. v County of San Luis Obispo* was running its course through the Court of Appeals. As staff is well aware, this case focused solely on the issue of whether Property Tax Rule 10(d) or Rule 10(e) controlled the assessment of Plaintiff's propane storage tanks. During the final hearing of this case, the County of San Luis Obispo took the position that the entire case was moot because Rule 124 had changed to include tanks as "fixtures" and that therefore Rule 10 no longer applied. As you can see, this position is entirely inconsistent with the CAA's current position.

Notwithstanding the above, and notwithstanding the fact that Rule 124 now classifies the tanks as fixtures, the Industry has been willing to allow specific reference within Rule 10 which deals with the proper evaluation of propane tanks. The Industry has taken this position because it does not really care under which Rule specific reference to the handling of propane tanks is found, so long as there is a specific reference. As the staff will recall, it was staff's request of the industry that it consider dropping its proposal that specific reference to propane tanks be found within Rule 10, in exchange for a new rule (153) which would make specific reference to propane tanks. As staff can now clearly see, the CAA wishes to undermine these efforts by deleting specific reference to propane tanks in Rule 10, and by eliminating Rule 153 entirely.

In conclusion, the CAA makes repeated reference to the case of *Xerox Corp. v. County of Orange* (1977) 66 Cal.App.3d, 746. The Industry would like to remind staff that this case is of absolutely no value in trying to determine the property valuation of propane storage tanks. In the case of *Platz et al., v County of San Luis Obispo*, the court of Appeals specifically noted that this case, along with others relied on by the assessor "...indicate that the 'trade level' theory should be applied to leased equipment. But, where it is necessary to determine which method of valuation under the 'trade level' theory is to be applied, they are not instructive." The Industry does not have any problem with the concept of trade level adjustment per se, only the County Assessor's improper application of it to propane storage tanks.

2. In the determination of a trade level factor, should the full economic cost include an allowance for non-property items?

Yes, there should be a trade level adjustment for non-property items.

[The following text was submitted by the California Taxpayers' Association (Cal-Tax). Text was not submitted by the Western Propane Gas Association regarding this topic.]

There should be a trade level adjustment for non-property items as already agreed to in the development of AH 504. This would encompass warranties or other non-property items included in the transaction as an appropriate deduction.

To omit the non-property items would put Rule 10 at variance with AH 504, which states on page 59 of the handbook:

"Adjustment may be appropriate when non-property items have been included in a purchase contract. Extended service plans and warranties, supplies, other purchased assets or business services may have been included in the purchase contract. An adjustment may be appropriate for the fair market value of these assets. The effect on the purchase price for any included financing should also be considered and an adjustment made if appropriate."

FORMAL ISSUE PAPER

Table 4B Discounts/Adjustments on the same page of the AH 504, then lists those items for which an adjustment is allowed for assessment purposes and includes:

- Quantity discount
- Cash discount
- Non-property items
- Seller rebates

Rule 10 would be incomplete if non-property items were not added to the list of allowable adjustments as well as inconsistent with the language agreed to and adopted in the AH 504 just last year.

In addition, precedent already exists in statute for allowing adjustments for the value of non-property items under Revenue and Taxation Code Sec. 998, pertaining to timeshares:

"The full value of a timeshare estate or a timeshare use subject to tax under this division shall be determined by finding the real property value of the interest involved and shall not include the value of any nonreal property items, including, but not limited to, vacation exchange rights, vacation conveniences and services, and club memberships."

As in the above example, the inclusion of non-property item adjustment in Rule 10 would only apply to self-consumed and leased property because of their unique situation. It would not open up the issue of deductions for non-property items included in a purchase for other non-similarly situated property. And the burden will be on the manufacturer/user or lessor to show evidence of the non-property item value.

FORMAL ISSUE PAPER**C. Cons of the Alternative**

1. General trade level principles can apply to any type of property. If applying a trade level adjustment to a fixture results in fair market value and equity between taxpayers, then it is an appropriate adjustment whether or not it is specifically identified in a Board rule. Thus, excluding fixtures from the rule does not mean that the trade level theory does not apply to fixtures; including fixtures in the rule would clarify that trade level may apply to fixtures.

Industry, both the California Taxpayers' Association (Cal-Tax) and the Western Propane Gas Association, appear to agree that the trade level concept applies to fixtures. They wish, however, to remain silent as to fixtures in Rule 10 to avoid its improper application. Industry states:

"Leaving Rule 10 silent as to fixtures does not absolutely preclude the use of trade level, but readers would not be unnecessarily confused by its inclusion."

(Cal-Tax, see Alternative 1, Pros)

"The Industry does not have any problem with the concept of trade level adjustment per se, only the County Assessors' improper application of it to propane storage tanks."

(Western Propane Gas Association, see Alternative 1, Pros)

This, in staff's view, is inappropriate. The rule should expressly state that trade level applies to fixtures, for purposes of clarity.

(See also Staff Recommendation, Pros of the Staff Recommendation)

2. The term "non-property items" is ambiguous as to what it includes, and may lead to assessment of property at less than fair market value. The term must be defined, as was done in AH 504, in order to be applied appropriately. Cautionary statements such as "the burden will be on the manufacturer/user or lessor to show evidence of the non-property item value" (see Cal-Tax text under Alternative 1, Pros) and a definition of the term would also be necessary in Rule 10.

The meaning of "non-property items" can only be determined from the statutes by excluding the things defined as property in section 103. This is not the way the term is being used in AH 504. Cal-Tax uses the term "non-property items" out of context and cites section 998 as precedent for using the term. However, section 998 uses the term "nonreal property", which has a completely different meaning. ("Real property" is specifically defined in the Revenue and Taxation Code (section 104). "Property" is defined broadly as "all matters and things, real, personal, and mixed, capable of private ownership" (section 103).)

Once defined, adjustments for non-property items are appropriate only when such costs are separately stated; i.e., they can be purchased separately from the product. The full economic cost of property, therefore, should not include an adjustment for non-property items unless separately stated and/or purchased. Industry uses *warranty* as an example of a "non-property item" for which an adjustment to full economic cost is necessary. Staff disagrees with a warranty adjustment to full economic cost unless it is separately stated, such as an extended warranty. Staff's proposed language, excluding non-property items such as warranties, as an adjustment to the trade level factor, is consistent with the trade level discussion in Assessors' Handbook Section 504 (AH 504), *Assessment of Personal Property and Fixtures*. The wording in this section of the handbook regarding warranty adjustments was presented to the Board in the form of a formal issue paper. (See issue paper number 98-036, December 1998.) At that time, the

FORMAL ISSUE PAPER

Board approved staff's wording that specifically did not include "warranty" as an adjustment in the determination of the trade level factor.

Further, in this instance, warranty adjustments are not appropriate unless separately stated since assessed value must be based on the value to a "typical" consumer of similar property. "Typical" consumers do not purchase property without warranties. This is true, in part, because certain warranties are required by law. These required warranties of merchantability and fitness may not be limited, modified, or disclaimed by the seller unless the property is sold "as is" or "with all faults" and the buyer is conspicuously and clearly informed as such in writing. Thus a purchase of property without warranty is not representative of a "typical" buyer. Allowing such an adjustment for self-consumed property gives the manufacturer an unfair advantage unless other customers are allowed to purchase the products similarly (i.e., there are two price lists: one with warranty and one without). It is in conflict with section 110 of the Revenue and Taxation Code ("...the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor the seller could take advantage of the exigencies of the other...") and the constitution which requires all taxable property be assessed at "fair market value" (California Constitution, article XIII § 1 (a)). Since warranties are the only non-property items specifically identified by Industry in "Pros of the Alternative", it is the only item addressed by staff in this issue paper. Staff is unable to address non-property items in general without specific information as to what is included in the term.

However, if the trade level adjustment is being determined for self-consumed property, other adjustments may be necessary to account for differences in the self-constructed equipment and equipment sold to the manufacturer's customers. As stated and discussed in AH 504, such discounts and/or appropriate retail selling prices for internally used equipment can be determined through (1) analysis of sales transactions or (2) use of a gross margin mark up method. When actual sales data is available, the first method is preferred. (See AH 504, December 1999, p. 64.)

[The following text was submitted by the California Assessors' Association (CAA).]

The deduction from full economic cost for "non-property items" is unclear and opens the door for assesseees to assert that warranties should be excluded in the cost approach. Companies that are the end users of equipment that they manufacture should be assessed at the same trade level as any other consumer of the product. Generally, other consumers cannot elect to give up the warranty on the product and pay a lower price for the product.

(See also Staff Recommendation, Pros of the Staff Recommendation.)

D. Statutory or Regulatory Change

Action by the Board on the attached Property Tax Rule will amend Section 10, Title 18 of the California Code of Regulations.

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

None

2. Revenue Impact

See attached Revenue Estimate

G. Taxpayer/Customer Impact

None

H. Critical Time Frames

The lien date is January 1 for the assessment year July 1 through June 30. In order for assessors to have this guidance for the processing of the 2000-01 roll the Board should authorize publication of amendments to the Rule at its November 1999 meeting.

Prepared by: Property Taxes Department; Policy, Planning, and Standards Division

Current as of: October 21, 1999

1 ATTACHMENT A

2
3 "SBE STAFF AND CAA VERSION"

4
5
6 **Rule 10 TRADE LEVEL FOR TANGIBLE PERSONAL PROPERTY**

7
8 *References:* Chapter 147, Statutes of 1966, First Extraordinary Session.
9 Sections 110, 401, Revenue and Taxation Code.

10
11 (a) In appraising tangible personal property, the assessor shall give recognition to the
12 trade level at which the property is situated and to the principle that property normally
13 increases in value as it progresses through production and distribution channels. Such
14 property normally attains its maximum value as it reaches the consumer level.
15 Accordingly, tangible personal property shall be valued by procedures that are consistent
16 with the general policies set forth herein. Trade level adjustments shall also be
17 considered when appraising personal property affixed to real property.

18
19 ~~(b) Tangible personal property in the hands of a primary producer which is produce of~~
20 ~~the soil and for which there are regular markets established by the buyers of the property,~~
21 ~~such as petroleum and other minerals, logs, livestock, and other farm products, shall be~~
22 ~~valued at the price offered by the buyers less the unincurred cost of preparing the~~
23 ~~property for market and of moving the property to the market place at which such price is~~
24 ~~applicable, or plus the cost of moving the goods from that market place to the place at~~
25 ~~which they are to be processed if the latter location is the tax situs.~~

26
27 (b) Except as provided by the following subdivisions, tangible personal property held by
28 a consumer shall be valued at the amount of cash or its equivalent for which the property
29 would transfer to a consumer of like property at the same trade level if exposed for sale
30 on the open market. This value shall be estimated in accordance with regulations 4, 6,
31 and 8. If a cost approach is employed, the cost shall include the full economic cost of
32 placing the property in service. Full economic cost (i.e., replacement or reproduction
33 cost), includes costs typically incurred in bringing the property to a finished state,
34 including labor and materials, freight or shipping cost, installation costs, sales or use
35 taxes, and additions for market supported entrepreneurial services (with appropriate
36 allowances for trade, quantity, or cash discounts).

37
38 ~~(c) Tangible personal property in the hands of a manufacturer who holds it for processing~~
39 ~~or for sale shall be valued at the amount for which it would transfer to other~~
40 ~~manufacturers of like property. This value shall be estimated (1) by reference to the cost~~
41 ~~of the property in its condition on the lien date or (2) by reference to the cash price at~~
42 ~~which the manufacturer is expected to sell the property less costs yet to be incurred and~~
43 ~~experienced gross profits. When the cost approach is used, there shall be added to the~~
44 ~~cost of raw materials all other direct costs and manufacturing burden, including~~
45 ~~depreciation and property taxes, but excluding selling and general administrative costs.~~

1 ~~Unprocessed raw material cost is the cost of replacement on the lien date as evidenced by~~
2 ~~recent purchases by the assessee or other recent market transactions.~~

3
4 (c) Tangible personal property leased, rented, or loaned for a period of six months or less,
5 having a tax situs at the place where the lessor normally keeps the property as provided in
6 regulation 204, shall be valued at the amount of cash or its equivalent for which it would
7 transfer to other lessors or retailers of like property. The value may be estimated by
8 reference to the price at which the lessor could be expected to sell the property at fair
9 market value to other lessors or retailers of like property. If that price is unknown, then
10 the value may be estimated by reference to one or more of the following indicators of
11 value: (1) the lessor's full economic cost of the property with a reasonable allowance for
12 depreciation; (2) the cost indicated in subdivision (e) if the lessor is also the
13 manufacturer; or (3) in accordance with subdivision (b).

14
15 ~~(d) Tangible personal property in the hands of a retail merchant who holds it for sale,~~
16 ~~lease, or rental shall be valued at the amount for which it would transfer to other retailers~~
17 ~~of like property; and tangible personal property in the hands of a wholesale merchant who~~
18 ~~holds it for sale, lease, or rental shall be valued at the amount for which it would transfer~~
19 ~~to other wholesalers of like property. This value shall be estimated (1) by reference to~~
20 ~~the property's cost to the merchant, including freight in and deducting trade, quantity, and~~
21 ~~cash discounts, with reasonable allowance based on proper substantiation for damaged,~~
22 ~~shopworn, out of style, used, or overage stock, or (2) by reference to the price at which~~
23 ~~the merchant is expected to sell the property less his experienced gross profit.~~

24
25 (d) Tangible personal property leased, rented, or loaned for an extended but unspecified
26 period or leased for a term of more than six months, having tax situs at the lessee's situs
27 as provided in regulation 204, shall be valued by estimating the cash price or its
28 equivalent for which the property could be sold at fair market value to an outside
29 customer operating at the same level of trade as the lessee. If that price is unknown, then
30 the value may be estimated by reference to one or more of the following indicators of
31 value: (1) the lessee's full economic cost of the property with a reasonable allowance for
32 depreciation, or (2) in accordance with subdivision (b).

33
34
35 ~~(e) Tangible personal property in the hands of a person who holds it for consumption~~
36 ~~shall be valued in accordance with sections 4, 6, and 8 of this subchapter. When,~~
37 ~~however, such property is leased or rented for a period of less than six months so that its~~
38 ~~tax situs, as provided in section 204 of this chapter is at the place where the lessor~~
39 ~~normally keeps the property, it shall be valued in accordance with the last sentence of~~
40 ~~subdivision (d).~~

41
42 (e) Tangible personal property acquired from internal sources for self-consumption or
43 use, shall be valued by estimating the cash price or its equivalent for which the property
44 could be sold at fair market value to an outside customer using the property at the same
45 trade level, (with appropriate allowances for trade, quantity, or cash discounts). If that
46 price is unknown, then the value may be estimated by reference to one or more of the

1 following indicators of value: (1) the cost of the property in its condition and location on
2 the lien date, had it been acquired at fair market value from an outside supplier (including
3 labor, materials, overhead, interdivisional and/or intercompany profits, interest on
4 borrowed or owner supplied funds, sales or use tax, installation, and other costs incurred
5 in bringing the property to a finished state, with appropriate allowances for trade,
6 quantity, or cash discounts, and depreciation), or (2) in accordance with subdivision (b).
7 The quantity discount allowed a manufacturer, when it is its own largest customer, should
8 be at least as large as that allowed its largest wholesale or retail customer.

9
10 ~~(f) When tangible personal property is in the hands of a person engaged in two or more~~
11 ~~of the functions of producer, manufacturer or processor, wholesaler, retailer, or~~
12 ~~consumer, the level of trade at which the property is held shall be determined by~~
13 ~~reference to its form, location, quantity, acquisition source, and probable purchasers or~~
14 ~~lessees. A person is operating at two or more levels when the property consists of raw~~
15 ~~materials, semi-manufacturers, or finished goods which were acquired from sources~~
16 ~~within a business entity (other than component parts meeting the tests of the following~~
17 ~~sentence) and the property is held (1) for consumption by the business entity or (2) for~~
18 ~~processing and/or marketing in competition with similar products marketed by other~~
19 ~~business entities that have purchased like raw materials, semi-manufacturers, or finished~~
20 ~~goods at the same stage of production from external sources. Component parts held at~~
21 ~~the manufacturing processing level, however, shall not be considered to be at a higher~~
22 ~~level than that at which they are manufactured when they have been manufactured by a~~
23 ~~business entity specifically and exclusively for (1) incorporation by the entity in its~~
24 ~~finished product, (2) marketing as replacement parts for its finished product, or (3) both.~~

25
26 ~~When it is concluded that the person holding tangible personal property is operating at~~
27 ~~more than one trade level, property at the higher trade level or levels acquired from~~
28 ~~internal sources shall be valued (1) by estimating what the property, in its condition and~~
29 ~~location on the lien date, would have cost had it been acquired in an arm's length~~
30 ~~transaction from an outside supplier, (2) by reference to the cash price at which the~~
31 ~~property could be sold in an arm's length transaction to an outside customer less a~~
32 ~~reasonable gross profit, or (3) if held at the consumer level, in accordance with~~
33 ~~subdivision (e).~~

34
35 ~~(g) Storage of tangible personal property in a warehouse, in and of itself, does not alter~~
36 ~~the trade level. The trade level of such property will be determined in accordance with~~
37 ~~subdivision (f).~~

38
39 (f) Tangible personal property in the hands of a person engaged in the function of a
40 manufacturer, wholesaler, or retailer and a consumer shall be valued by estimating the
41 cash price or its equivalent for which the property could be sold at fair market value to an
42 outside customer operating at the same level of trade. The property shall be valued based
43 on how it is situated or used on the lien date pursuant to subdivisions (b), (c), (d), and (e).
44

45
46 *History:* Adopted June 21, 1967, effective July 23, 1967.

1 Amended February 18, 1970, effective March 26, 1970.
2 Amended January 6, 1971, effective February 18, 1971.
3 Amended April 19, 1971, effective May 22, 1971.
4

ATTACHMENT B
"INDUSTRY VERSION"

Rule 10 TRADE LEVEL FOR TANGIBLE PERSONAL PROPERTY

References: Chapter 147, Statutes of 1966, First Extraordinary Session.
Sections 110, 401, Revenue and Taxation Code.

(a) In appraising tangible personal property, the assessor shall give recognition to the trade level at which the property is situated and to the principle that property normally increases in value as it progresses through production and distribution channels. Such property normally attains its maximum value as it reaches the consumer level. Accordingly, tangible personal property shall be valued by procedures that are consistent with the general policies set forth herein.

~~(g) Tangible personal property in the hands of a primary producer which is produce of the soil and for which there are regular markets established by the buyers of the property, such as petroleum and other minerals, logs, livestock, and other farm products, shall be valued at the price offered by the buyers less the unincurred cost of preparing the property for market and of moving the property to the market place at which such price is applicable, or plus the cost of moving the goods from that market place to the place at which they are to be processed if the latter location is the tax situs.~~

(b) Except as provided by the following subdivisions, tangible personal property held by a consumer shall be valued at the amount of cash or its equivalent for which the property would transfer to a consumer of like property at the same trade level if exposed for sale on the open market. This value shall be estimated in accordance with regulations 4, 6, and 8. If a cost approach is employed, the cost shall include the full economic cost of placing the property in service. Full economic cost (i.e., replacement or reproduction cost), includes costs typically incurred in bringing the property to a finished state, including labor and materials, freight or shipping cost, installation costs, sales or use taxes, and additions for market supported entrepreneurial services (with appropriate allowances for trade, quantity, or cash discounts; and non-property items).

~~(h) Tangible personal property in the hands of a manufacturer who holds it for processing or for sale shall be valued at the amount for which it would transfer to other manufacturers of like property. This value shall be estimated (1) by reference to the cost of the property in its condition on the lien date or (2) by reference to the cash price at which the manufacturer is expected to sell the property less costs yet to be incurred and experienced gross profits. When the cost approach is used, there shall be added to the cost of raw materials all other direct costs and manufacturing burden, including depreciation and property taxes, but excluding selling and general administrative costs. Unprocessed raw material cost is the cost of replacement on the lien date as evidenced by recent purchases by the assessee or other recent market transactions.~~

1
2 (c) Tangible personal property leased, rented, or loaned for a period of six months or less,
3 having a tax situs at the place where the lessor normally keeps the property as provided in
4 regulation 204, shall be valued at the amount of cash or its equivalent for which it would
5 transfer to other lessors or retailers of like property. The value may be estimated by
6 reference to the price at which the lessor could be expected to sell the property at fair
7 market value to other lessors or retailers of like property. If that price is unknown, then
8 the value may be estimated by reference to one or more of the following indicators of
9 value: (1) the lessor's full economic cost of the property with a reasonable allowance for
10 depreciation; (2) the cost indicated in subdivision (e) if the lessor is also the
11 manufacturer; or (3) in accordance with subdivision (b).

12
13 ~~(i) Tangible personal property in the hands of a retail merchant who holds it for sale,~~
14 ~~lease, or rental shall be valued at the amount for which it would transfer to other retailers~~
15 ~~of like property; and tangible personal property in the hands of a wholesale merchant who~~
16 ~~holds it for sale, lease, or rental shall be valued at the amount for which it would transfer~~
17 ~~to other wholesalers of like property. This value shall be estimated (1) by reference to~~
18 ~~the property's cost to the merchant, including freight in and deducting trade, quantity, and~~
19 ~~cash discounts, with reasonable allowance based on proper substantiation for damaged,~~
20 ~~shopworn, out-of-style, used, or overage stock, or (2) by reference to the price at which~~
21 ~~the merchant is expected to sell the property less his experienced gross profit.~~

22
23 (d) Tangible personal property leased, rented, or loaned for an extended but unspecified
24 period or leased for a term of more than six months, having tax situs at the lessee's situs
25 as provided in regulation 204, shall be valued by estimating the cash price or its
26 equivalent for which the property could be sold at fair market value to an outside
27 customer operating at the same level of trade as the lessee. If that price is unknown, then
28 the value may be estimated by reference to one or more of the following indicators of
29 value: (1) the lessee's full economic cost of the property with a reasonable allowance for
30 depreciation, or (2) in accordance with subdivision (b).

31
32
33 ~~(j) Tangible personal property in the hands of a person who holds it for consumption~~
34 ~~shall be valued in accordance with sections 4, 6, and 8 of this subchapter. When,~~
35 ~~however, such property is leased or rented for a period of less than six months so that its~~
36 ~~tax situs, as provided in section 204 of this chapter is at the place where the lessor~~
37 ~~normally keeps the property, it shall be valued in accordance with the last sentence of~~
38 ~~subdivision (d).~~

39
40 (e) Tangible personal property acquired from internal sources for self-consumption or
41 use, shall be valued by estimating the cash price or its equivalent for which the property
42 could be sold at fair market value to an outside customer using the property at the same
43 trade level, (with appropriate allowances for trade, quantity, or cash discounts). If that
44 price is unknown, then the value may be estimated by reference to one or more of the
45 following indicators of value: (1) the cost of the property in its condition and location on
46 the lien date, had it been acquired at fair market value from an outside supplier (including

1 labor, materials, overhead, interdivisional and/or intercompany profits, interest on
2 borrowed or owner supplied funds, sales or use tax, installation, and other costs incurred
3 in bringing the property to a finished state, with appropriate allowances for trade,
4 quantity, or cash discounts; depreciation, and non-property items), or (2) in accordance
5 with subdivision (b). The quantity discount allowed a manufacturer, when it is its own
6 largest customer, should be at least as large as that allowed its largest wholesale or retail
7 customer.

8
9 ~~(k) When tangible personal property is in the hands of a person engaged in two or more~~
10 ~~of the functions of producer, manufacturer or processor, wholesaler, retailer, or~~
11 ~~consumer, the level of trade at which the property is held shall be determined by~~
12 ~~reference to its form, location, quantity, acquisition source, and probable purchasers or~~
13 ~~lessees. A person is operating at two or more levels when the property consists of raw~~
14 ~~materials, semi-manufacturers, or finished goods which were acquired from sources~~
15 ~~within a business entity (other than component parts meeting the tests of the following~~
16 ~~sentence) and the property is held (1) for consumption by the business entity or (2) for~~
17 ~~processing and/or marketing in competition with similar products marketed by other~~
18 ~~business entities that have purchased like raw materials, semi-manufacturers, or finished~~
19 ~~goods at the same stage of production from external sources. Component parts held at~~
20 ~~the manufacturing processing level, however, shall not be considered to be at a higher~~
21 ~~level than that at which they are manufactured when they have been manufactured by a~~
22 ~~business entity specifically and exclusively for (1) incorporation by the entity in its~~
23 ~~finished product, (2) marketing as replacement parts for its finished product, or (3) both.~~

24
25 ~~When it is concluded that the person holding tangible personal property is operating at~~
26 ~~more than one trade level, property at the higher trade level or levels acquired from~~
27 ~~internal sources shall be valued (1) by estimating what the property, in its condition and~~
28 ~~location on the lien date, would have cost had it been acquired in an arm's length~~
29 ~~transaction from an outside supplier, (2) by reference to the cash price at which the~~
30 ~~property could be sold in an arm's length transaction to an outside customer less a~~
31 ~~reasonable gross profit, or (3) if held at the consumer level, in accordance with~~
32 ~~subdivision (e).~~

33
34 ~~(g) Storage of tangible personal property in a warehouse, in and of itself, does not alter~~
35 ~~the trade level. The trade level of such property will be determined in accordance with~~
36 ~~subdivision (f).~~

37
38 (f) Tangible personal property in the hands of a person engaged in the function of a
39 manufacturer, wholesaler, or retailer and a consumer shall be valued by estimating the
40 cash price or its equivalent for which the property could be sold at fair market value to an
41 outside customer operating at the same level of trade. The property shall be valued based
42 on how it is situated or used on the lien date pursuant to subdivisions (b), (c), (d), and (e).

43
44
45 *History:* Adopted June 21, 1967, effective July 23, 1967.
46 Amended February 18, 1970, effective March 26, 1970.

1 Amended January 6, 1971, effective February 18, 1971.
2 Amended April 19, 1971, effective May 22, 1971.
3

ATTACHMENT C

RULE 10 ISSUE PAPER MATRIX

Wording Differences Between Staff and Assessors (Attachment A) and Industry (Attachment B)

Item	Paragraph	Source	Position
1. Do trade level adjustments apply in the valuation of personal property that has been affixed to real property (fixtures)?			
1(a)	Title	SBE Staff & CAA	Change title of Rule 10. Trade Level for Tangible Personal Property
1(b)	Paragraph (a), last sentence	SBE Staff & CAA	Add following sentence: <u>Trade level adjustments shall also be considered when appraising personal property affixed to real property.</u>
2. In the determination of a trade level factor, should the full economic cost include an allowance for warranties?			
2(a)	Paragraph (b), last sentence	Industry	Addition to SBE staff & CAA version: ...(with appropriate allowances for trade, quantity, or cash discounts; <u>and non-property items</u>).
2(b)	Paragraph (e), second sentence	Industry	Addition to SBE staff & CAA version: ...with appropriate allowances for trade, quantity, or cash discounts; depreciation, <u>and non-property items</u>)

**BOARD OF EQUALIZATION
REVENUE ESTIMATE**

ISSUE #99-050**Property Tax Rule 10, Trade Level for Tangible Personal Property****Proposal**

Board staff has proposed amendments for Property Tax Rule 10, Trade Level for Tangible Personal Property.

Background, Methodology, and Assumptions

Under the trade level concept, property is assessed based on how it is situated on the lien date. Trade level adjustments ensure that property is valued at market value and are most frequently applicable to leased equipment and to equipment that is self-constructed and self-consumed by the manufacturer.

The two areas of disagreement between the staff proposal and the alternative offered by industry are the adjustment for non-property items and the deletion of references to trade level adjustments for fixtures. The version of Rule 10 proposed by industry includes an allowance for non-property items and would most affect valuations in the computer hardware manufacturing industry.

Staff estimates that the statewide total for personal property and fixtures values for computer hardware manufacturers is less than \$10 billion and that up to one-half of this, \$5 billion, is self-constructed and self-consumed equipment that will be affected by the trade level adjustments. It is estimated that the allowance for non-property items proposed by industry would result in a reduction in the range of one to ten percent. Statewide, the annual maximum reduction in assessed value under the alternative proposal is then:

$$\$5 \text{ billion} \times (1\% \text{ to } 10\%) = \$50 \text{ million to } \$500 \text{ million.}$$

Another unresolved item is the reference to fixtures; it is deleted in the industry's version of Rule 10. This deletion should not have a revenue effect since the application of the trade level principle is inherent in arriving at fair market value. Rule 10 only gives clarification of the application of the trade level principle. The assessors should continue to apply trade level adjustments to fixtures with or without the explicit reference.

Revenue Summary

There is no revenue change for the staff recommendation. Under the industry proposal, the decrease in property taxes at the basic one percent property tax rate is between \$500,000 and \$5 million [(\$50 million to \$500 million) x 1 percent] annually.

Preparation

This revenue estimate was prepared by Aileen Takaha Lee, Statistics Section, Agency Planning and Research Division. The estimate was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division, and by Mr. Richard C. Johnson, Deputy Director, Property Taxes Department. For additional information, please contact Ms. Lee at 445-0840.

Current as of October 28, 1999.